Equity Analysis of Service Corporation International

by

Andrew J. Hanley

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Approved by:

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Delbert Goff, Ph.D., Thesis Director

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Chris McNeil, Ph.D., Second Reader

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Dawn Medlin, Ph.D., Walker College of Business Honors Director

Abstract

This paper is an equity analysis of Service Corporation International (SCI) conducting research through security analysis. Based off of the research and valuation of SCI, I have recommended a Buy recommendation. As the largest provider of death care services and products in North America they are well positioned to benefit the most from the aging population. The company has three strategies for capturing potential sales through preneed cemetery sales, pre-need funeral sales, and at-need sales. This allows the death care company to focus on a wider range of customers, age wise, allowing them to work with people who could have potentially decades left in their life span. Moving forward SCI will benefit from their company's large size and backlog. Compared to industry competitors that are publicly traded are incredibly small when stacked up against SCI. Most of the competition facing SCI is due to positioning, SCI operates in a highly fragmented industry with many small locally owned private operations. Many consumers choose their death care provider based off familiarity and geographic positioning. When looking at the company's backlog they have $10.7 billion in unrecognized sales. These sales will be recognized when the time comes to perform the customer's service. The company is currently traded on the NYSE and has a current PE ratio of 15.20.

Summary of Key Financial Information			
Market Cap.	$7.16B	L-T Debt/Equity (mrq)	219%
Total Assets (mrq)	$12.4B	Beta	.9
Total Liabilities (mrq)	$10.9B	Dividend Yield (ttm)	1.84%
Sales (ttm)	$3.11B	Dividend (ttm)	$.68
Net Income (ttm)	$461.9M	PEG Ratio	1.26
Gross Margin (ttm)	23.8%	Price/Sales (ttm)	2.3
EBIT Margin (ttm)	18.7%	Price/Book (mrq)	4.52
Net Margin (ttm)	14.6%%	Fiscal Year End	12/31
Return on Equity (ttm)	33.8%	Most Recent Quarter	4/25/2018

Company Overview

Service Corporation International (SCI) is the leading provider of death care products and services in the United States; they were incorporated in Texas, in 1962. Their business model has transitioned greatly from when they were first founded. SCI originally focused on efficiencies of scale by reducing overhead costs, accounting, transportation, and personnel among funeral service locations. Overtime, SCI expanded this model to other death care companies through acquisitions. Today, they operate over 1,400 funeral locations and 473 cemeteries across 45 US states and eight Canadian provinces. They have a multitude of different brands that serve a wide variety of customer needs. Different business brands include categories such as funeral service provider, cemeteries, and cremations.

Industry Outlook

SCI operates in two industries, the cemetery services industry and funeral home industry, in the US. Both industries are expected to have slow and consistent growth as America's population continues to age, and both industries have many of the same drivers. The largest threat to these industries is the rising popularity of cremations, which will negatively affect the funeral homes industry, and it hurts the margins of the cemetery services industry (Oliver, K).

Culturally, the funeral and cemetery industries have seen shifts in consumer preferences. Cremations have grown exponentially in popularity, and there are two main factors contributing to this trend. This is due to the financial crisis in 2007 and the relaxation of religious rules towards burials. After the financial crisis, the US economy entered into a recession that left consumers strapped for cash. This led them to deviate towards cremations due to the affordability of the process which is on average 40% less than a typical burial. The second factor attributing to increased cremation popularity is the growing leniency towards religions letting their followers break the long tradition of burials (McGinley, D).

There is also a shift in these industries as to how these funeral and cemetery services are carried out. Traditionally a funeral includes a wake or viewing where guests come and pay their respects. Then there is a funeral service where this can occur at a home, church, or at graveside. During the service there is usually music, religious readings, and singing of hymns. If the family plans on burying the deceased then there is usually a vehicle procession to the cemetery and later there is sometimes a reception to share memories, laughter, and support. (Traditional Funeral).

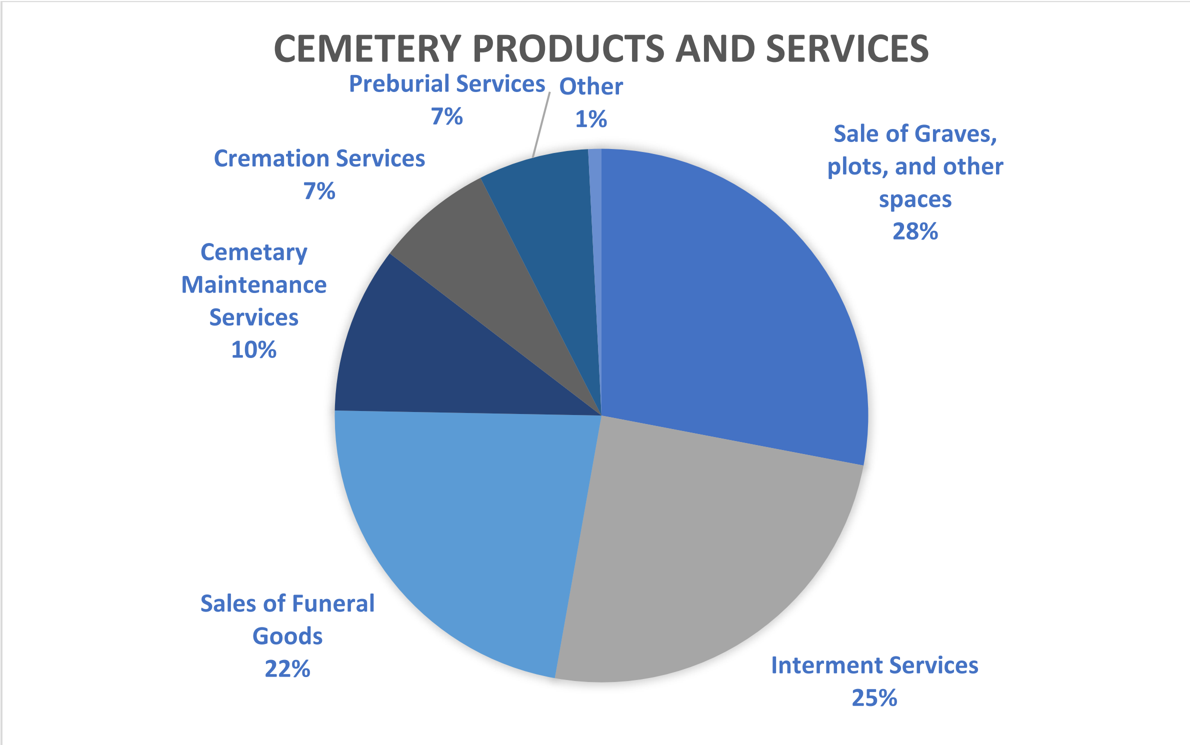
Now this trend is changing and consumers are getting more creative, creating some opportunities for entrepreneurs and potential threats to established businesses. If death care companies don't adopt new higher margin services, then many businesses may begin shutting doors. People are getting creative with cremated remains, this could include placement in biodegradable containers or creating diamonds with it. One man had a favorite golf course where he hit many balls into a lake there, his friend rowed his cremated remains out into the middle of the water and dropped his ashes into it while over 70 individuals chipped golf balls into the lake. This is incredibly different than a traditional funeral and established businesses are attempting to find ways to offer more custom products and personalized services.

One business, Dodge Co. who is the world's largest supplier of embalming fluid has been selling more sports themed urns and video tributes. This is just one out of many companies adjusting to shifting preferences, some other new products and services being offered include catering, helping plan dinners, arranging bereavement rates at hotels, rifle holders in the casket, caskets to resemble your favorite vehicles, underwater mausoleums, and many more unique and creative ideas. (Johnston, K)*Cemetery Services Industry*

The cemetery services industry includes places of business that operate sites or areas reserved for the internment of human or animal remains and cremation services. This industry is highly fragmented with many privately held businesses, but large publicly traded companies include Service Corporation International, 17.5% market share, and their closest competitor StoneMor Partners LP, 5.4% market share. Key drivers for cemetery services in the US include number of deaths, per capita disposable income, the number of adults aged 65 and older, and number of cremations. This industry has yearly revenue of about $4.1 billion and has had an annual growth rate of 2.2% since 2012. It is expected that sales will be hurt due to an increasing preference for cremations, which is a low margin service.

This industry has seen growth during the past five years due to increased consumer spending for additional sales of value-added services and products. For example, consumers can purchase high margin items such as burial vaults, specialized urns, limousine services, and flower decorations (Johnston, K). Historically, consumers have been strapped for cash and could not afford the more expensive higher profit margin packages like grave plots and caskets. The industry's main source of revenue, as seen in chart one, comes from the collective sale of gravesites, niches and spaces in mausoleums, and columbaria (Oliver, K).

Chart One

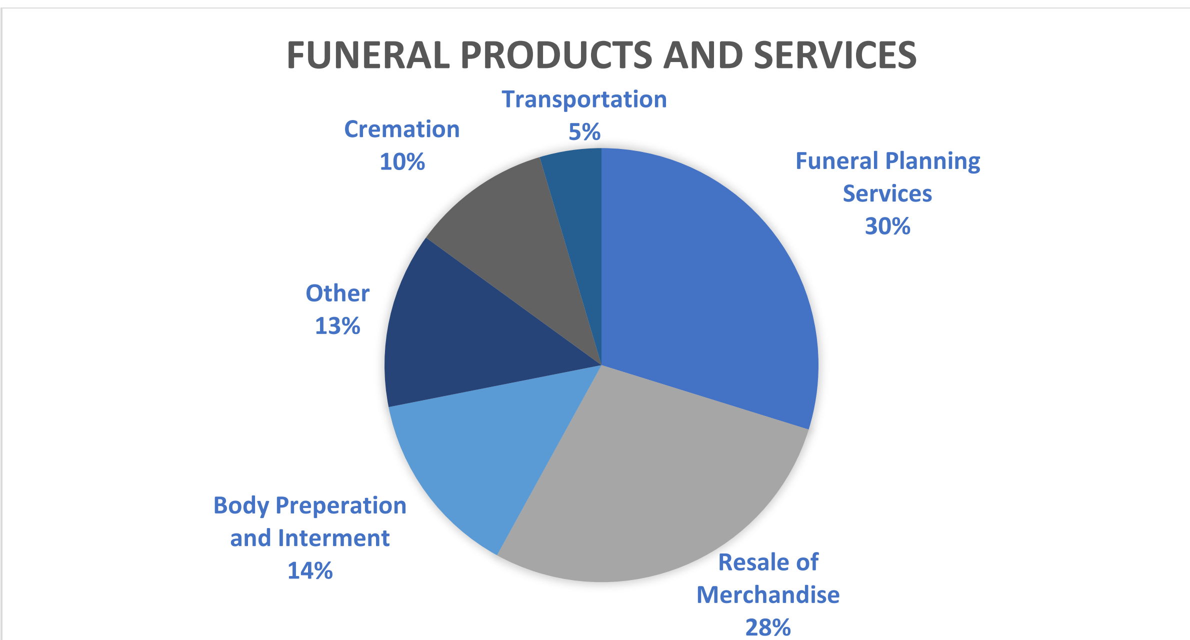


Funeral Homes Industry

This industry includes companies that conduct funerals and prepare the deceased for burial or internment. These businesses organize wakes, transport the dead, sell caskets, and related merchandise. As seen in Chart Two, the majority of sales come from funeral planning services, resale of merchandise, and body preparation. This industry is also highly fragmented, but there is less major competition from other publicly traded companies. SCI accounts for 10.9% of the industry's market share, other publicly traded companies such as StoneMor Partners and Carriage Services account for less than 2% of industry revenues. The funeral homes industry has many of the same drivers as the cemetery services industry, but, cremations are negatively impacting gross margins for the funeral home industry. This industry had yearly revenue of $16.1 billion, in 2017, and had an annual growth rate of 1.7%, since 2012. One main driver for this industry is the growth in e-commerce sales where consumers can now buy their caskets online.

This industry has experienced slow and consistent growth due to the aging of the population. Historically, many religions have frowned upon cremations, but recently religions are beginning to relax these rules and there has been a spike in the number of cremations. In 2010, 40% of individuals were cremated; in 2016, that number increased to 50%. Funeral homes have high fixed costs related to facilities, equipment, permits, and staff. The operator’s ability to be profitable is determined by increases in sales volumes and generating more revenue per customer. The high fixed costs of staff includes skilled labor, such as morticians and staff who can react to the emotions of customers (McGinley, D).

Chart Two



Company Outlook

Corporate strategy

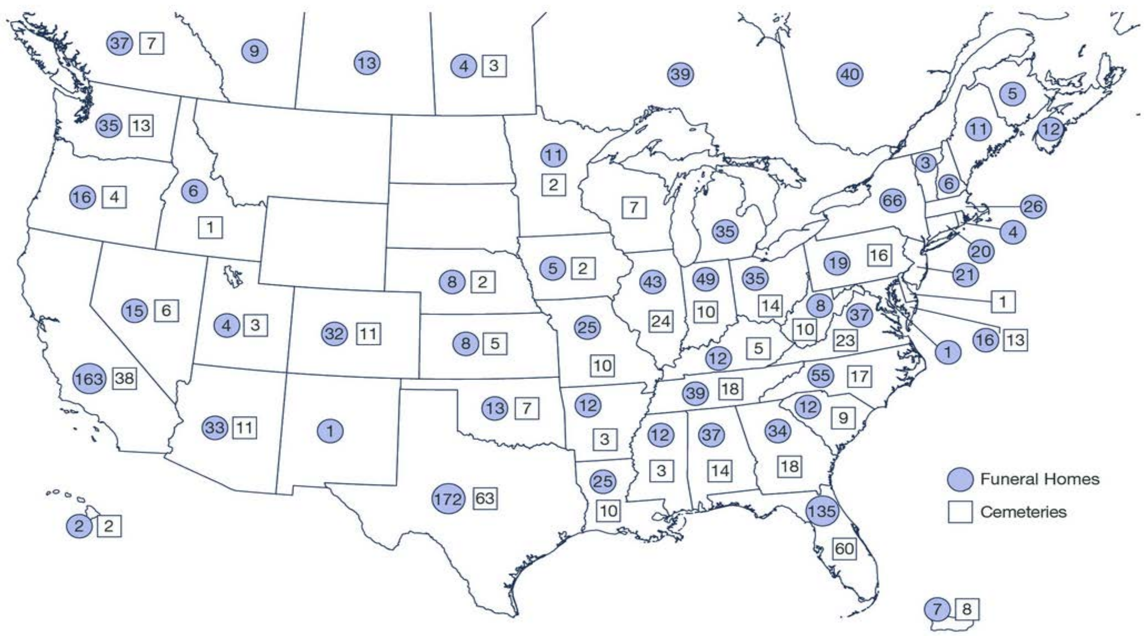
SCI has room for long lasting, increasing, streams of revenue, as a large portion of North America begins to age. As the largest provider of death care products, they will benefit the most from the aging Baby Boomers, who represent about one quarter of the US population. The amount of disposable income available to Baby Boomers will also hinder or help SCI. Consumers will be willing to pay for more expensive products and services offered by SCI, if they have more disposable income, but if it is the opposite, SCI will still capture their business, but it will be directed towards lower margin products and services, such as cremation.

To capture customers, SCI has three different market categories. They have pre-need cemetery consumers, who are in their late fifties to early sixties. The average age of a pre-need funeral consumer is late sixties to early seventies. Finally, the average age of their at-need consumer is late seventies to early eighties. Pre-need customers are individuals who are planning for their cemetery or funeral experience in advance and at-need customers are people who have passed away and their family is taking care of the arrangements. SCI has seen considerable growth already, from Baby Boomers in their pre-need cemetery segment, and expect the next boom of revenue growth to come from their pre-need funeral segment. The company has laid out a plan, see Appendix A Table 1, with three steps; grow revenue, leverage unparalleled scale, and deploy capital (SCI 10-K 2017).

Geographic Size

Due to the sheer size of SCI, they will be able to capture much of the graying population of America. In 2017, the funeral and cemetery industries made $20 billion of revenue off of 3 million deaths. Right now, Baby Boomers are in an age range of 54 to 72 years old and compose about 25% of the population (Just How Many). As these individuals age, they will begin to investigate pre-need options and eventually at-need options. SCI has close to 2,000 locations across the United States, as seen in Chart Three, which are in place to capture a large amount of the business of these individuals.

Chart Three



**Source: SCI SEC 10-k filing 2017*

Large Backlog

SCI has accumulated a backlog of $10.7 billion that can be used to generate additional streams of revenue, this backlog is created from the sales of pre-need contracts. While this backlog does create a liability for services and products that need to be performed in the future; it still has many positive impacts for SCI. This backlog is used for trust investments, which gives SCI access to reputable money managers with low fee structures. SCI retains the funds that are above the amount required to be deposited into trust accounts and uses the excess amount for working capital purposes, usually to offset the administrative costs of their pre-need programs. This revenue can help SCI achieve extra revenue and it locks in customers to prevent them from switching to a competitor. Additionally, SCI leverages this backlog to create greater brand awareness, secure future market share, and diversify their revenue stream.

Different Business Models

There are many different cultures and levels of economic status within the United States. SCI is aware of this and has developed different business lines, as seen in Chart Four, to meet a wide array of customer needs. They have high end lines, such as Dignity Memorial and Making Everlasting Memories. They also have affordable option lines such as Advantage. The main difference between these business lines is that the higher end focuses on higher margin services and products such as custom themed funeral services, choosing your cemetery property, and planning your traditional funeral. The Advantage line is a lower quality website compared to Dignity Memorial and the pages main focus is on low cost non-customizable cremations or funerals.

They are well positioned to capture consumer’s growing preference towards cremations, with lines such as the National Cremation Society and Neptune Society, the largest cremation provider in the US. There is even an attempt to capture cultural customers with segments, such as Funeraria Del Angel, which recognizes that Hispanic populations need a specialized grievance package (SCI Website).

Chart Four

Brands Owned by SCI	Description
Dignity Memorial Brand	First transcontinental brand of deathcare products. Helps families make final arrangments.
Dignity Planning	Has an online planning tool to help make final arrangements simpler.
National Cremation Society	Established in 1973, this is the USA's oldest and largest cremation service.
Advantage Funeral and Cremation Services	Economic alternative to pricey funeral services. A funeral service in its simplest form.
Funeraria del Angel	Targets hispanic populations and gives professional service to cater cultural needs.
Making Everlasting Memories	Helps celebrate life and life events. To share the stories of loved ones.
Neptune Society / Trident Society	Economic alternative for cremations.

**Source: SCI Website*

Sustainable Competitive Advantages

SCI has one main competitive advantage that is not paralleled by any other corporation, its size. In the fragmented funeral homes industry, about 86% of the companies are private. The remaining 14% is split between Carriage Services, StoneMor Partners, and SCI (McGinley, D). Carriage Services and StoneMor both account for 2% and SCI accounts for the remaining 12% looming over any other potential competitor. Within the cemetery services industry, they have another unparalleled advantage in size accounting for 17.5% of the industry's market share. The current trend of the US population is towards cremations which is expected to hurt both industries, but SCI is poised to benefit from this trend due to their business line Neptune Society, the largest provider of cremation services. Due to their large size SCI is able to compete on price. SCI has strong pricing power because they either saturate markets or buy competitors. This allows them to charge much higher prices than their competitors, on average their prices are about 40% higher than their surrounding competition (Paul, K).

Financial Analysis

Extended DuPont Table

Extended DuPont Analysis	2013	2014	2015	2016	2017
EBIT Margin	15.20%	20.29%	18.43%	16.89%	18.39%
Total asset turnover	0.20	0.25	0.25	0.25	0.24
Leverage Multiplier*	6.13	5.64	6.42	7.06	5.74
Tax Burden	0.60	0.43	0.63	0.54	1.36
Interest Burden	0.63	0.66	0.67	0.64	0.70
Return on equity	7.00%	8.16%	12.81%	10.38%	24.63%

*Reflects the subtraction of pre-need funeral and cemetery receivables

EBIT Margin

SCI's financial growth is due to the continued aging of the Baby Boomer population and SCI's ability to attract customers to their pre-need business segments. This has led to increased revenues over the past five years, as we can see when looking at the income statement in Appendix A. Moving forward, I forecast continued steady revenue growth at a rate close to GDP growth, see Appendix B Forecasts. In 2017, SCI reported a gross margin of 23%, which is an increase of over a percentage point from 2013. In 2017, as seen in the Extended DuPont Table SCI had an 18% EBIT margin, they have very few line items that severely impact them and most fluctuation comes from SG&A; to help support their 23,000-employee base. This is partially because SCI includes their largest expense, which is overhead, within their COGS. If SCI did not do this, then their gross margins would likely be in a range of 45%-50% for their funeral and cemetery segments.

Total Asset Turnover

When viewing the Extended DuPont Table, SCI has seen a stagnant number for its total asset turnover (TAT), around .25. However, in the most recent year, the TAT dropped to .24, due to a spike in cash and equivalents being held on the balance sheet, as well as, an increase in pre-need funeral receivables and cemetery perpetual care trust investments, see the Appendix A balance sheet. Historically, SCI has used cash and cash equivalents for open market debt purchases.

Leverage Multiplier

SCI consistently buys back shares through their share repurchase program. In 2017 and 2016, SCI repurchased almost $200 million worth of shares each year, in 2018 the company is authorized to buy back $400 million worth of shares. This helps contribute to the large multiplier of 5.74 and is reflective of the company's business model of using debt to fund the company's acquisitions. When viewing the common size balance sheet as a percentage of total assets in Appendix A, long-term debt significantly stands out, representing 20% of the company's liabilities, in 2017.

Tax Burden

SCI has seen a major beneficial impact to their companies ROE from tax benefits, causing a marginal tax rate of negative 36%. SCI says that this tax benefit was due to a settlement between them and the IRS as well as a settlement of employee share based awards. SCI, historically, has had a higher tax rate, and in 2016 this higher tax rate was due to a valuation allowance against foreign net deferred tax assets. This tax rate has historically fluctuated and is one of the main factors affecting the company's wide ranges of EPS values, Appendix B Table 3.

Interest Burden

SCI had a decreased impact from interest burden and the company gained an increased ROE because of this. The interest burden tells us how much the company's line items between pretax income and EBIT, such as interest expense affects the overall return on equity. In 2017, the interest burden, which is pretax income divided by the company's operating margin (EBIT) was at .70 up from the previous year's .64, indicating a lesser affect from line items between EBIT and pretax income. This is not because of a decreasing interest expense, it actually increased by $7 million, but rather a smaller expense from the early extinguishment of long-term debt.

Stock Valuation

For the valuation of SCI, I used two valuation metrics; EV/EBITDA, and discounted cash flow. For the EV/EBITDA multiple, I used SCI's trailing 12-month average, a value of 12.4 to capture the company's operations from the most recent year, see Appendix B Table 1 for more details on justification. For the discounted cash flow I received a perpetual value of $47.77 and an EBITDA value of $37.62, I then averaged these two values together to receive a value of $42.69, see Appendix B Discounted Cash Flow. After equally weighting the average DCF values at a 50% weighting with the EV/EBITDA value at 50%, I achieved a one-year target price of $45, this is in line with other analyst expectations as seen in Appendix B Table 2.

I did not use a P/E multiple, the trailing values captured non-recurring events such as hurricane expenses and company tax benefits. For the forward P/E estimates, I believe that these are too low based on future potential with high margin services and continued Baby Boomer deaths. The line item affecting my valuation the most, is the company's general and administrative expense. This expense increased from 2016 due to additional legal expenses, pension termination, self-insurance reserves, and expenses related to updating the company's website.

Investment Risks

FTC Blocking Business Deals

SCI has a history of making major acquisitions within their industry, and becoming an industry consolidator. They are well known for buying other funeral and cemetery companies and keeping the same management and company name. Since the beginning of 2006, SCI has made some major acquisitions, including the second largest company in the death care industry, the Alderwoods Group, the fifth largest company Keystone North America, USA's largest direct cremation organization, the Neptune Society, and Stewart Enterprises, the next second largest death care company after Alderwoods. SCI moving forward, plans to use $50 to $100 million of their capital as funds for acquisitions, in the upcoming year. As the largest player in their industry, SCI faces potential blocking of acquisitions by the Federal Trade Commission (FTC). For example, in the recent acquisitions of Keystone North America and Stewart Enterprises, the FTC made SCI sell 75 funeral homes and 44 cemeteries (Providence).

Medical Advances Extending Life

SCI revolves around the ending of the human life cycle; the advancement of medical practices hurts SCI. As people begin to live longer, it delays the amount of expected revenue generated by different generations. While these individuals can still be a part of SCI's pre-need business model, the company will have to alter current models and increase the ages for their packages that target the different demographics.

Cremation Popularity

The current trend in the United States towards cremations is hurting overall industry revenue. This is harmful to SCI, because cremations are low margin services, hurting their burial business, which is 40% more expensive than a cremation. The largest reason for the growing trend is that religions are becoming less strict on their burial practices, and after the financial crisis, cremations gained popularity due to its affordability. SCI has prepared for this growing trend by increasing their presence in this market. In 2011, SCI acquired the Neptune Society, which has become the nation's largest provider of cremation services. Recently, profit margins have been boosted by value added services to offset the negative effects of cremations. Value added services have included flowers decorations, limousine services, and other high value products.

Recommendation

SCI is a BUY at their current price of $36 and a target price of $45, providing a potential return of 18%. The company has seen consistent yearly returns on their common stock, averaging a 21% return YOY over the past five years. This is due to their large exposure to the aging American population, their ability to capture backlog, and their attractive financial valuation.

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Appendix A

Financial Statements and Ratios

Balance Sheet (in thousands except share amounts)								
Fiscal Year	2013	2014	2015	2016	2017	MRQ	FY2018	FY2019
Assets:								
Current Assets								
Cash and cash equivalents	144,873	177,335	134,599	194,986	330,039	219,507	221,327	226,214
Receivables, net	105,899	109,050	90,462	98,455	90,304	77,080	107,437	104,935
Deferred Tax assets	39,074	-	-	-	-	-	-	-
Inventories	34,565	29,697	27,835	26,431	25,378	26,955	25,516	25,663
Current assets held for sale	4,569	-	-	-	-	-	-	-
other	64,767	80,774	55,513	34,524	35,575	27,463	35,575	35,575
total current assets	393,747	396,856	308,409	354,396	481,296	351,005	389,855	392,387
preneed funeral receivables, net and trust investments	1,870,874	1,843,023	1,760,297	4,305,165	4,778,842	4,199,414	4,826,630	4,874,897
preneed cemetary receivables, net and trust investments	2,300,911	2,306,669	2,318,167	-	-	-	-	-
cemetary property	1,749,067	1,739,216	1,753,015	1,776,935	1,791,989	1,794,070	1,791,989	1,791,989
PPE	1,922,961	1,861,403	1,846,722	1,827,587	1,873,044	1,890,475	1,964,026	2,057,016
Non current assets held for sale	737,552	-	-	-	-	-	-	-
goodwill	1,922,102	1,810,853	1,796,340	1,799,081	1,805,981	1,819,134	1,794,263	1,785,163
Deferred charges and other assets	661,234	624,248	616,511	567,520	601,184	877,690	601,184	601,184
Cemetary Perpetual care trust investments	1,347,622	1,341,376	1,319,427	1,407,465	1,532,167	1,497,220	1,532,167	1,532,167
Total assets	**12,906,070**	**11,923,644**	**11,718,888**	**12,038,149**	**12,864,503**	**12,429,008**	**12,900,114**	**13,034,803**

Appendix A continued,

Liabilities and Equity:	2013	2014	2015	2016	2017	MRQ	2018	2019
Current Liabilities								
Revolver	-	-	-	-	-	-	46,792	187,663
Accounts Payable and accrued liabilities	486,648	453,042	422,842	439,936	489,172	469,159	488,627	476,451
current maturities of long term debt	146,362	90,931	95,181	89,974	337,337	89,249	342,786	64,665
current liabilities held for sale	3,183	-	-	-	-	-	-	-
income taxes payable	6,391	8,035	1,373	7,960	2,470	33,397	2,470	2,470
total current liabilities	642,584	552,008	519,396	537,870	828,979	591,805	880,674	731,249
long term debt	3,155,548	2,963,794	3,071,738	3,196,616	3,135,316	3,316,695	2,792,530	2,727,865
deferred funeral revenue	686,299	540,164	557,897	1,731,417	1,789,776	1,337,045	1,789,776	1,789,776
deferred cemetary revenue	923,155	1,062,381	1,120,001	-	-	-	-	-
deferred tax liability	619,200	448,824	470,584	454,638	283,765	341,272	283,765	283,765
Non current liabilities held for sale	428,053	-	-	-	-	-	-	-
other liabilities	430,393	502,553	496,921	510,322	410,982	403,877	410,982	410,982
deferred receipts held in trust	3,250,586	3,148,884	2,973,386	3,103,796	3,475,430	3,431,781	3,510,184	3,545,286
care trusts corpus	1,345,874	1,327,658	1,319,564	1,408,243	1,530,818	1,494,684	1,530,818	1,530,818
total liabilities								
Equity								
common stock (combined with capital after 2017)	212,317	204,867	195,773	189,405	186,615	184,012	1,171,418	1,186,009
capital in excess of par value	1,259,348	1,186,304	1,092,106	990,203	970,468	961,744	-	-
retained earnings (accumulated deficit)	(145,876)	(81,859)	(109,351)	(103,387)	210,364	333,864	488,024	787,110
Accumulated other comprehensive income	88,441	59,414	6,164	16,492	41,943	32,125	41,943	41,943
total common stockholders equity	1,414,230	1,368,726	1,184,692	1,092,713	1,409,390	1,511,745	1,701,385	2,015,062
noncontrolling interests	10,148	8,652	4,709	2,534	47	104	-	-
total equity	1,424,378	1,377,378	1,189,401	1,095,247	1,409,437	1,511,849	1,701,385	2,015,062
total liabilities and equity	12,906,070	11,923,644	11,718,888	12,038,149	12,864,503	12,429,008	12,900,114	13,034,803

Appendix A continued,

Income Statement (In thousands except per share amounts)								
Fiscal Year	2013	2014	2015	2016	2017	TTM	FY2018	FY2019
Revenue	2,550,466	2,994,011	2,986,041	3,031,137	3,095,031	3,111,800	3,161,819	3,231,630
Costs and Expenses	(2,001,419)	(2,318,326)	(2,311,452)	(2,354,703)	(2,372,842)	(2,371,000)	(2,408,237)	(2,445,251)
Operating Profit	549,047	675,685	674,589	676,434	722,189	740,800	753,582	786,379
SG&A	(155,128)	(184,749)	(130,813)	(137,730)	(154,423)	(133,800)	(157,755)	(161,238)
Gains (losses) on divestitures and impirment charges, net	(6,263)	116,613	6,522	(26,819)	7,015	-	-	-
Hurricane expenses, net	-	-	-	-	(5,584)	-	-	-
Operating Income	387,656	607,549	550,298	511,885	574,781	607,000	595,827	625,141
Revolver expense	-	-	-	-	-	-	468	2,345
Interest Expense	(142,360)	(177,571)	(172,897)	(162,093)	(169,125)	(172,100)	(161,967)	(158,216)
Losses on early extinguishment of debt, net	468	(29,158)	(6,918)	(22,503)	(274)	1,300	(274)	(274)
Other Income (expense), net	(558)	1,780	(132)	(631)	460	(24,100)	5,514	4,475
Income from continuing Operations before income taxes	245,206	402,600	370,351	326,658	405,842	412,100	439,568	473,470
Benefit from (provision for) income taxes	(93,024)	(225,980)	(135,027)	(149,353)	146,589	42,000	(92,309)	(99,429)
Income from continuing operations	152,182	176,620	235,324	177,305	552,431	454,100	347,259	374,042
Net loss from discontinued operations	406	2,186	(390)	-	-	-	-	-
Net income	152,588	178,806	234,934	177,305	552,431	454,100	347,259	374,042
Net Income attributable to non-controlling interests	(5,256)	(6,337)	(1,162)	(267)	(184)	(200)	(184)	(184)
Net Inome to common stockholders	147,332	172,469	233,772	177,038	552,247	453,900	347,075	373,858

Appendix A continued,

Common Size Balance Sheet % of Total Assets								
Fiscal Year	2013	2014	2015	2016	2017	MRQ	FY2018	FY2019
Assets:								
Current Assets								
Cash and cash equivalents	1%	1%	1%	2%	3%	2%	2%	2%
Receivables, net	1%	1%	1%	1%	1%	1%	1%	1%
Deferred Tax assets	0%	0%	0%	0%	0%	0%	0%	0%
Inventories	0%	0%	0%	0%	0%	0%	0%	0%
Current assets held for sale	0%	0%	0%	0%	0%	0%	0%	0%
other	1%	1%	0%	0%	0%	0%	0%	0%
total current assets	3%	3%	3%	3%	4%	3%	3%	3%
preneed funeral receivables, net and trust investments	14%	15%	15%	36%	37%	34%	37%	37%
preneed cemetary receivables, net and trust investments	18%	19%	20%	0%	0%	0%	0%	0%
cemetary property	14%	15%	15%	15%	14%	14%	14%	14%
PPE	15%	16%	16%	15%	15%	15%	15%	16%
Non current assets held for sale	6%	0%	0%	0%	0%	0%	0%	0%
goodwill	15%	15%	15%	15%	14%	15%	14%	14%
Deferred charges and other assets	5%	5%	5%	5%	5%	7%	5%	5%
Cemetary Perpetual care trust investments	10%	11%	11%	12%	12%	12%	12%	12%
Total assets	100%	100%	100%	100%	100%	100%	100%	100%
Liabilities and Equity:								
Current Liabilities								
Revolver	0%	0%	0%	0%	0%	0%	0%	1%
Accounts Payable and accrued liabilities	4%	4%	4%	4%	4%	4%	4%	4%
current maturities of long term debt	1%	1%	1%	1%	3%	1%	3%	0%
current liabilities held for sale	0%	0%	0%	0%	0%	0%	0%	0%
income taxes payable	0%	0%	0%	0%	0%	0%	0%	0%
total current liabilities	5%	5%	4%	4%	6%	5%	7%	6%
long term debt	24%	25%	26%	27%	24%	27%	22%	21%
deferred funeral revenue	5%	5%	5%	14%	14%	11%	14%	14%
deferred cemetary revenue	7%	9%	10%	0%	0%	0%	0%	0%
deferred tax liability	5%	4%	4%	4%	2%	3%	2%	2%
Non current liabilities held for sale	3%	0%	0%	0%	0%	0%	0%	0%
other liabilities	3%	4%	4%	4%	3%	3%	3%	3%
deferred receipts held in trust	25%	26%	25%	26%	27%	28%	27%	27%
care trusts corpus	10%	11%	11%	12%	12%	12%	12%	12%
Equity								
common stock (combined with capital after 2017)	2%	2%	2%	2%	1%	1%	9%	9%
capital in excess of par value	10%	10%	9%	8%	8%	8%	0%	0%
retained earnings (accumulated deficit)	-1%	-1%	-1%	-1%	2%	3%	6%	8%
Accumulated other comprehensive income	1%	0%	0%	0%	0%	0%	0%	0%
total common stockholders equity	11%	11%	10%	9%	11%	12%	15%	18%
noncontrolling interests	0%	0%	0%	0%	0%	0%	0%	0%
total equity	11%	12%	10%	9%	11%	12%	15%	18%
total liabilities and equity	100%	100%	100%	100%	100%	100%	100%	100%

Appendix A continued,

Common Size Income Statement as a % of revenue								
Fiscal Year	2013	2014	2015	2016	2017	TTM	FY2018	FY2019
Revenue	100%	100%	100%	100%	100%	100%	100%	100%
Costs and Expenses	-78%	-77%	-77%	-78%	-77%	-76%	-76%	-76%
Operating Profit	22%	23%	23%	22%	23%	24%	24%	24%
SG&A	-6%	-6%	-4%	-5%	-5%	-4%	-5%	-5%
Gains (losses) on divestitures and impirment charges, net	0%	4%	0%	-1%	0%	0%	0%	0%
Hurricane expenses, net	0%	0%	0%	0%	0%	0%	0%	0%
Operating Income	15%	20%	18%	17%	19%	20%	19%	19%
Revolver expense	0%	0%	0%	0%	0%	0%	0%	0%
Interest Expense	-6%	-6%	-6%	-5%	-5%	-6%	-5%	-5%
Losses on early extinguishment of debt, net	0%	-1%	0%	-1%	0%	0%	0%	0%
Other Income (expense), net	0%	0%	0%	0%	0%	-1%	0%	0%
Income from continuing Operations before income taxes	10%	13%	12%	11%	13%	13%	14%	15%
Benefit from (provision for) income taxes	-4%	-8%	-5%	-5%	5%	1%	-3%	-3%
Income from continuing operations	6%	6%	8%	6%	18%	15%	11%	12%
Net loss from discontinued operations	0%	0%	0%	0%	0%	0%	0%	0%
Net income	6%	6%	8%	6%	18%	15%	11%	12%
	0%	0%	0%	0%	0%	0%	0%	0%
Net Income attributable to non-controlling interests	0%	0%	0%	0%	0%	0%	0%	0%
Net Inome to common stockholders	6%	6%	8%	6%	18%	15%	11%	12%

Appendix A continued,

PROFITABILITY	2013	2014	2015	2016	2017	TTM	FY2018	FY2019
Gross Profit Margin	21.53%	22.57%	22.59%	22.32%	23.33%	23.81%	23.83%	24.33%
EBIT Margin	15.20%	20.29%	18.43%	16.89%	18.57%	19.51%	18.84%	19.34%
EBITDA Margin	20.46%	25.41%	23.63%	22.21%	24.00%	0.00%	23.72%	24.13%
Pretax Profit Margin	9.61%	13.45%	12.40%	10.78%	13.11%	13.24%	13.90%	14.65%
Net Profit Margin	5.78%	5.76%	7.83%	5.84%	17.84%	14.59%	10.98%	11.57%
Return on Assets	1.18%	1.50%	2.00%	1.47%	4.29%	3.65%	2.69%	2.87%
Return on Equity	10.34%	12.52%	19.65%	16.16%	39.18%	30.02%	20.40%	18.55%
Return on Invested Capital	5.09%	6.01%	8.03%	6.34%	16.03%	12.34%	9.64%	9.89%
YOY Growth in Revenue	0.00%	17.39%	-0.27%	1.51%	2.11%	-10.08%	2.16%	2.21%
YOY Growth in Net Income	0.00%	17.06%	35.54%	-24.27%	211.94%	-12.06%	-37.15%	7.72%
YOY Growth in Diluted EPS	0.00%	18.05%	42.01%	-21.02%	218.10%	-10.98%	-37.15%	7.72%
ASSET MANAGEMENT								
Inventory Turnover	57.90	78.07	83.04	89.09	93.50	87.96	94.38	95.28
Tangible Asset Turnover	0.27	0.32	0.32	0.31	0.30	0.32	0.30	0.30
Fixed Asset Turnover	1.33	1.61	1.62	1.66	1.65	1.65	1.61	1.57
Total Asset Turnover	0.20	0.25	0.25	0.25	0.24	0.25	0.25	0.25
LEVERAGE and LIQUIDITY								
Times Interest Earned	2.72	3.42	3.18	3.16	3.40	3.53	3.68	3.95
Long-Term Debt-to-Equity	2.22	2.15	2.58	2.92	2.22	2.19	1.64	1.35
Debt-to-Invested Capital	0.67	0.67	0.71	0.73	0.64	0.67	0.57	0.55
Total Debt Ratio	0.89	0.88	0.90	0.91	0.89	0.88	0.87	0.85
Equity Multiplier	9.06	8.66	9.85	10.99	9.13	8.22	7.58	6.47
Current Ratio	0.61	0.72	0.59	0.66	0.58	0.59	0.44	0.54
Quick Ratio	0.39	0.52	0.43	0.55	0.51	0.50	0.37	0.45

Appendix A continued,

Table 1

Grow Revenue	**Remain Relevant to the Customer**: keeping up with cultural trends **Growing pre-need sales**: drives future and current revenue growth, has 4,300 counselors on this sales team, and helps establish brand awareness
Leverage Our Unparalleled Scale	**Developing our sales organization**: investment in infrastructure and training of sales organization, utilization of customer relationship management system **Using our scale with pre-need backlog**: access to recognized financial partners, access to low fee structures, trust and insurance investments can't be replicated by competition **Optimizing our network and deploying customer facing technology**: drive operating discipline, leveraging scale through standardized processes, and capitalizing new technologies for consumer use
Deploy Capital	**Investing in acquisitions and building new funeral homes**: target businesses with favorable customer dynamics and achieve additional economies of scale, building funeral homes in areas with favorable demographics, create more opportunities to sell to Baby Boomers **Paying Dividends**: target a payout ratio of 30% to 40% **Repurchasing shares**: lack of strategic acquisitions will mean repurchasing shares of common stock **Repurchasing Debt**: maintain liquidity and financial flexibility, seeking open market debt purchases to manage debt load

*Source: SCI 10-K 2017

Appendix B

Stock Valuation

Forecast Table

Income Statement Assumptions	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
YOY Revenue Growth	0%	17.39%	-0.27%	1.51%	2.11%	2.16%	2.21%	2.26%	2.31%	2.36%
Gross Profit Margin	21.53%	22.57%	22.59%	22.32%	23.33%	23.83%	24.33%	24.83%	25.33%	25.83%
SG&A	6.08%	6.17%	4.38%	4.54%	4.99%	4.99%	4.99%	4.99%	4.99%	4.99%
Tax Rate	37.94%	56.13%	36.46%	45.72%	-36.12%	21.00%	21.00%	21.00%	21.00%	21.00%
EBITDA Reconciliation										
EBIT	387,656	607,549	550,298	511,885	574,781	595,827	625,141	655,779	687,818	721,339
Depreciation and Amortization	122,235	140,002	141,456	147,233	153,141	139,866	140,077	141,306	143,639	145,811
Stock Based Compensation	11,925	13,127	13,843	14,056	14,788	14,335	14,591	15,015	15,266	15,544
EBITDA	521,816	760,678	705,597	673,174	742,710	750,028	779,809	812,100	846,723	882,694

Forecasts

I have made a few assumptions for SCI's income statement moving forward concerning their forecasts. Due to slow and consistent growth from aging Baby Boomers, industry growth is expected to be similar to the growth rate of GDP. Currently, industry trends signify the creation of additional value-added services that will boost gross margins, increasing slightly for the upcoming years. The next assumption I made was that tax rates will become normalized at 21% due to the new Tax Act from 2017.

For SCI's balance sheet my major assumptions were associated with the company's ability to increase pre-need sales and the decreasing of long-term debt. I believe that SCI will continue to make pre-need sales causing an increase pre-need funeral and cemetery receivables as well as an increase in the liability line item, deferred receipts held in trust. I have both of these forecasted to increase at slow rates. Due to SCI's high leverage, I foresee them slowing down on the amount of large acquisitions financed with debt. I believe that the company will continue to be an industry consolidator but with a smaller acquisition budget. I have the amount of long-term debt on the balance sheet decreasing moving forward as the company focuses on paying it down.

Appendix B continued,

Discounted Cash Flow

Fair value per share	Perpetuity	EBITDA
Enterprise value	12,205,946	7,177,395
Less: Net debt	(296,856)	(296,856)
Less: Trapped cash	(35,443)	(35,443)
Equity value	**9,183,178**	**7,231,475**
Diluted shares	192,246.000	192,246.000
Equity value per share	**$47.77**	**$37.62**
Market premium / (discount) to fair value	(24.6%)	(4.3%)

*Source: analyst calculations

Appendix B continued,

Valuation Calculation

Valuation Based on P/E		
Expected Diluted EPS		$1.81
Justified P/E		19.9
Target Price	**$**	**35.87**

Valuation Based on EV/EBITDA		
Calculation of Enterprise Value		
Expected EBITDA	$	750,028
Justified EV/EBITDA		12.4
Enterprise Value	**$**	**9,262,847**
Calculation of Expected Net Debt		
Current portion of L-T debt		337,337
Current portion of capital leases		-
Short term debt		3,967,072
Long term debt		3,135,316
Capital leases		-
Minority interest		47
Preferred stock		-
Other		-
Less: Excess cash		330,039
Less: Investment securities		4,778,842
Less: Other Nonoperating assets		2,133,351
Less: Equity investments		-
Net Debt	**$**	**197,540**
Calculation of Equity Value		
Enterprise Value		9,262,847
Less: Net Debt		197,540
Equity Value	**$**	**9,065,307**
Calculation of Equity Value per Share		
Equity Value		9,065,307
Shares outstanding		187,630
Equity value / share	**$**	**48.31**

Targe Price Calculation			
Method	**Value**	**Weight**	**Product**
P/E Multiple	$ 35.87	0.0%	-
EV/EBITDA Multiple	$ 48.31	50.0%	24.16
Discounted Cash Flow	$ 42.69	50.0%	21.35
		Target Price Per Share	**$ 45.50**

Estimating Required Rate of Return on Equity	
Risk-free rate	3.00%
Market risk premium	5.5%
Beta	0.9
Required Rate of Return	8.0%
Size Premium	1.98%
Required Return Adjusted for Size	9.9%

Current Value Calculation		
Target Price	$	45.50
Required Return		9.9%
Number of months to discount		12
Current value	**$**	**41.39**

Margin of Safety Calculation		
Current Stock Value	$	41.39
Current Stock Price	$	38.70
Margin of Safety		7.0%

Source: Analyst Calculations

Appendix B continued,

Table 1

Justified EV/EBITDA	
Current EV/EBITDA	12.4
Last 5 years EV/EBITDA	10.5
Last 34 quarters EV/EBITDA	9.3
Last 35 quarters EV/EBITDA	9.3
Current EV/EBITDA for most comparable company	34.6
Current EV/EBITDA of comparable companies	23.7

*Source: Bloomberg

I used the current trailing twelve months EV/EBITDA multiple. This is most reflective of their current operating environment and a good indication of what to expect moving forward. It is not useful to compare SCI to other publicly traded companies because of their large size, and no other company can compete.

Appendix B continued,

Table 2

Analyst Concensus

Firm	Analyst	Action	Recommendation	Tgt Px	Date	1 Yr Rtn
Oppenheimer & Co	Scott A Schneeberger	M	outperform	42	04/29/18	15.29%
Credit Suisse	A J Rice	M	outperform	46	04/26/18	
Raymond James	John W Ransom	M	strong buy	42	04/26/18	15.29%
EVA Dimensions	Anthony Campagna	M	underweight		03/22/18	

*Source: Bloomberg

Appendix B continued,

Table 3

SCI Historical EPS

Fiscal Year	EPS	1-year growth rate
2017	2.91	216%
2016	0.92	-21%
2015	1.17	43%
2014	0.82	17%
2013	0.7	-1%
2012	0.71	15%
2011	0.62	22%
2010	0.51	4%
2009	0.49	29%
2008	0.38	-56%
2007	0.87	
5 year average		51%
10 year average		27%
Based off of 5 year EPS growth	$	4.43
Based off of 10 year EPS growth	$	3.73
My EPS estimate	$	1.85

*Source: Bloomberg